SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author:	Leno	Analyst:	LuAnna Hass	Bill Number:	AB 1690
Related Bills:	See Prior Analysis	Telephone:	845-7478	Amended Date:	August 18, 2003
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Local General Income Tax/Public Safety Finance Agency

____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended ____________________.

____ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

__X__ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as amended July 2, 2003.

__X__ FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO ____________________.

__X__ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED July 2, 2003, STILL APPLIES.

____ OTHER - See comments below.

SUMMARY

This bill would give the Franchise Tax Board (FTB) the authority to administer and collect a local income tax where voters approve the tax.

This bill also would add provisions regarding public safety finance agencies and property taxes. These changes do not affect the department and are not discussed in this analysis.

SUMMARY OF AMENDMENTS

The August 18, 2003, amendments deleted the provisions that would state the intent of the Legislature to examine 1) allowing local governments to impose a personal income tax, and 2) the revenue sources available to local governments. The intent language was replaced with provisions similar to the provisions in the July 2, 2003, version of the bill. Specifically, these amendments would:

- Allow any county or city and county (hereinafter referred to for ease of discussion as "county") to form a public safety finance agency. In addition, this bill would allow any county that has formed such an agency to levy a general tax for each taxable year on or after January 1, 2004, on the taxable income of any person residing in the county where the agency was formed.
- Specify that the tax may not exceed an amount equal to the net tax multiplied by 10%.

Board Position:			Legislative Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Roger Lackey for Brian Putler	8/20/03
____ N	____ OUA	__X__ PENDING		

- Provide that any ordinance or resolution adopted by a county for the purpose of levying a tax on income would not become effective unless approved by a majority of the voters at an election. Upon approval of the tax, the governing body of the county must give notice of such approval to FTB. Within 60 days of the notice of approval, FTB must estimate the amount of tax to be collected in the first 12 months in which the tax is imposed and notify the county auditor.
- Require FTB to administer and collect the local income tax. Specifically, these amendments would create Part 10.1 of the Revenue and Taxation Code and the provisions of that part would:

  - Require FTB to revise the personal income tax (PIT) forms to allow individuals to report a local income tax and require the city and county of their residence to be designated on the return;
  - Require the county to notify FTB by June 1st of any calendar year of the passage of a measure to impose a local income tax, which would allow FTB sufficient time to revise the PIT forms and booklets;
  - Clarify that FTB would administer and collect the local income tax in the same manner as PIT, which would include, but not be limited to, the assessment of penalties, interest, fees, and deficiency assessments;
  - Define “resident” as an individual who resides in the county for more than six months during the taxable year;
  - Specify that FTB would transmit the local income tax revenue, less any refunds, to the appropriate county;
  - Specify that the order of payment priority of a local income tax delinquency would fall after child support and other taxes collected by FTB as specified under current law;
  - FTB would transmit the local income tax within 60 days of the date the PIT return is processed or FTB collects any unpaid local income tax;
  - Require FTB to transmit the appropriate penalties and interest attributable to the local income tax to the county;
  - Require the county to enter into a contractual agreement with FTB to provide for reimbursement of FTB’s expenses;
  - Allow FTB to determine an individual’s county of residence in the event the individual fails to include the information on the tax return; and
  - Allow FTB to treat the omission on the return of the taxpayer’s county as a math error, which would allow FTB both to calculate the local income tax and to send a notice of tax due to the taxpayer.

For convenience, the remaining concerns and the fiscal impact as discussed in the department’s analysis of the bill as amended July 2, 2003, are provided below. The remainder of the department’s analysis of the bill as amended July 2, 2003, still applies.

EFFECTIVE/OPERATIVE DATE

This bill would be effective and operative January 1, 2004.

POSITION

Pending.

ANALYSIS

IMPLEMENTATION CONSIDERATIONS

This bill would have a significant impact upon the department. As described below under "Fiscal Impact," the department would incur costs to change the tax forms, instructions and booklets and to program, test, and maintain departmental systems. In addition, the department has identified the following concerns:

This bill would require FTB to estimate, based on historical data, the amount of local general tax to be collected in the first 12 months in which the tax is imposed. Generally, estimates of revenue projections are made by a state agency other than FTB that has the appropriate information and systems to make such estimates. If FTB were required to estimate the local income tax that could be collected, the methodology would be imprecise and could result in substantial errors for specific localities.

In addition, this bill requires FTB to transmit the local income taxes collected within 60 days after processing the return or collecting the tax, whichever is later. Assuming the taxpayer were to self-assess the local income tax on the PIT return, FTB receives PIT returns and payments daily from January through April 15th and, for taxpayers with an extension, through October 15th. However, in order to ease administration for FTB, the department would likely remit the funds weekly or monthly, which would have a minor impact on current fiscal operations.

TECHNICAL CONSIDERATIONS

Amendment 1 is provided as a technical amendment to correct a cross-reference within the provisions of the Revenue and Taxation Code relating to local income tax.

FISCAL IMPACT

Below is a general description of additional work that would be required by the department in order to administer a local income tax program:

- FTB would incur significant system programming hours. The department would need to create codes and program the systems to identify and calculate the tax for each county.
- The amount of the local income tax reported on a return would be adjusted in those instances where a mathematical correction is made to a return during processing that would change a taxpayer's PIT liability. The taxpayer would either get a reduced refund or be billed for the additional local income tax.
- The department would need to significantly modify the billing system for those taxpayers who fail to report or pay the local income tax.
- All of the information relating to the local income tax would need to be captured and retained in the department's systems.
- Although a worksheet and instructions would be provided in the PIT booklet, the department anticipates an increase in taxpayer contacts to the department for assistance in calculating the local income tax.
- There would be an increase in the department's collection activities for those taxpayers who fail or refuse to report or pay a local income tax.

For purposes of this estimate, the department used the San Diego County population that filed approximately 1.1 million PIT returns. As a result, the department has identified a preliminary implementation cost estimate of $3.5 - $3.7 million. Total costs include changes to the tax forms, instructions and booklets, programming, testing, and maintaining departmental systems, processing hours, remittance of the local income tax to the appropriate county, and the development and negotiation of agreements to ensure taxpayer privacy and non-disclosure of taxpayer information. Of the $3.5 - $3.7 million estimated above, approximately $2.4 million is for systems updates and the printing of PIT booklets to include a new worksheet and the various codes. The $2.4 million cost is not based on the population of a specific county and would be consistent regardless of the number of counties that may enact a local income tax. Any cost in excess of the $2.4 million would be based on the population of a specific county. Therefore, the department's cost could increase significantly depending on the number and population of counties or cities and counties that may enact a local income tax.

This bill does not include a provision to cover FTB's start-up costs. To ensure the department has the funding to implement this bill, the department would suggest the author add appropriation language to this bill that would cover the start-up costs of implementation. At a minimum, department staff suggests appropriation language that would provide FTB $100,000 for the 2003/2004 fiscal year to create or modify a system to estimate the local income tax that could be collected and $2.3 million for the 2004/2005 fiscal year due to the significant tax forms changes and the programming and testing effort required. The department is currently working on Budget Change Proposals (BCPs) for the 2004/2005 fiscal year and deficiency requests for the 2003/2004 fiscal year. However, absent an appropriation or Department of Finance approval of a BCP for the 2004/2005 fiscal year or a deficiency request for the 2003/2004 fiscal year, the department would be required to redirect staff from other revenue generating activities of the department, such as collections administration or audit, to administer this bill.

ECONOMIC IMPACT

This bill would not impact the state's income tax revenue.

ARGUMENTS/POLICY CONCERNS

This bill could be seen to result in inequitable treatment between classes of taxpayers. For example, the local income tax under this bill would not be levied against 1) individuals who do not have a PIT filing requirement because they do not meet the income thresholds for filing a PIT return, or 2) all businesses and corporations that do business within the area of the local income tax, even though everyone within the area would realize the benefits of the public safety finance agency.

This bill would authorize the imposition of a local income tax upon the taxable income of any person who is a resident of that locality and the tax may not exceed an amount equal to the net tax multiplied by 10% depending on the taxpayer's locale. However, state tax law allows taxpayers to claim certain tax credits that are used to reduce the taxpayer's tax liability dollar-for-dollar. For example an individual with taxable income of $100,000 and one personal exemption would have a PIT net tax of $7,342. If the taxpayer resided in a county that imposed a local general tax of 10%, the local general tax amount would be $734. That same taxpayer could have credits equaling $1,000, which would reduce their tax to $6,342, but their local income tax would still be $734. Calculating the local tax based on net tax could give the appearance that taxpayers would be paying more than the 10% of net tax liability.

Since this bill does not currently contain a provision to require employers to increase withholding from an employee’s (taxpayer's) wages, it is possible that a taxpayer who resides in a county that enacts a local income tax would not have sufficient withholding to cover both his or her PIT liability and the local income tax liability for a taxable year. As a result, the taxpayer may be subject to underpayment penalties.

The majority of tax returns are filed on a calendar-year basis. The local income tax would be reported on tax returns filed after the close of that calendar year. For fiscal purposes, ideally, the estimate of local income tax and the collection of the tax would be made for the same taxable year as the tax is reported on the return. However, the timeliness of the transfer of money to the local jurisdiction may be an issue. Local jurisdictions generally operate on a fiscal year basis. For those returns filed and processed by April 15th the local jurisdiction would likely receive the transfer of tax before the end of one fiscal year. For tax returns filed by the extended due date in October, the local income tax amounts would be transferred to the local jurisdiction in the next fiscal year.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 1690
As Amended August 18, 2003

AMENDMENT 1

On page 12, line 13, strikeout "This section" and insert:

Section 17041.5